IN THE

Supreme Court of the United States

October Term, 1962.

No. 880.

THEODORE F. APPLEBY and MARIE W. APPLEBY,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION.

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ARGUMENT.

1. Respondent's summary of its legal argument set forth on pages 5 and 6 of its brief reveals clearly and concisely that the Third Circuit's holding in the case at bar is based on regulations declared invalid by the Sixth Circuit.

Respondent's basic premise is regulations Section 1.355. "Section 1.355 provides that there must be a separation of two or more existing businesses" (R5). This premise is then amplified: "in order to constitute a separate business . . . the business must . . . not be merely incidental to the business of the distributing corporation" (R5, R6). The facts are then applied to the premise: "the Tax Court . . . concluded . . . that agency rental activities were only incidental to the operation of the brokerage business". (R6).

The Sixth Circuit, however, held the regulations Section 1.355-1 invalid in *Commissioner v. Coady*, 33 T. C. 771; aff'd 289 F. 2d 490 (C. A. 6th):

> ". . . there being no language, either in the statute or committee report, which denies tax free treatment under Section 355 to a transaction solely on the grounds that it represents an attempt to divide a single trade or business, the Commissioner's regulations which impose such a restriction are invalid."

Thus the conflict between the cases and the circuits stands out boldly.[1]

Respondent states that the issue at bar is the question stated not the negative but the question stated in the af-

[1] See note 47 Cornell Law Quarterly 108 (1961), where the author concluded on the basis of **Commissioner v. Coady**, supra, that the unjustified prohibition against separation of owner occupied realty was "in the past"

firmative[2] and on this basis distinguishes this case from the *Coady* case. The case below was lost ostensibly not because it was a single business that was attempted to be divided but because it was not two businesses which were attempted to be separated. Can it be possible that on such a purported distinction a taxpayer should suffer at the hands of his government the financial calamity faced by petitioners?

2. The recent case of *Estate of Parshelsky v. Commissioner*, Fed. 2nd (C. A. 2d) May 3, 1962, Docket No. 26851; C. C. H. Dec. 84, 332, which is cited in respondent's brief, page 8, footnote 4, should be brought to the Court's attention. The *Parshelsky* case and the cases of *Bondy v. Commissioner*, 269 F. 2d 463 (4th Cir. 1959), and *Edythe L. Wilkins v. U. S.*, 188 F. Supp. 91 (S. D. Ill., 1960), involve wholly owner occupied buildings which were spun-off in a qualified divisive reorganization. In each case the Court had no difficulty in recognizing the real estate operation as the continuation of the active conduct of a trade or business. If this is true for wholly owner occupied realty, a fortiori fifty (50%) per cent occupied realty such as that involved here must qualify.

These cases arise under the 1951 amendment to the 1939 Code Section 112 (b) (1). This Section is virtually iden-

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[2] Respondent infers (R7) that the equal division of all of the assets in **Coady** is the distinguishing factor. Note that in the decision the court specifically states that this happens to be the facts in **Coady** but does not rely on this in setting forth its general rule

> ". . . we do not think it inevitably follows, that each such trade or business necessarily must have been conducted on an individual basis throughout that 5 year period. As long as the trade or business which has been divided has been actively conducted for 5 years preceding the distribution, and the resulting businesses (each of which in this case, happens to be half of the original whole) are actively conducted after the division, we are of the opinion that the active business requirements of the statute have been complied with"

tical with Section 355 (b) (2) (B) of the 1954 Code, the section on which the case at bar turns.[3]

The 1951 Code provision disqualified a reorganization when

> "A. Any Corporation which is a party to such reorganization was not intended to continue the active conduct of a trade or business."

The regulations 39.112 (b) (11) -2a provided:

> "The underlying assumption of Section 112 (b) (11) and of the rules applicable to the reorganizations is that the reorganization and distribution of stock must result in a continuation of the old business activities and in a continuation of the interests of the shareholders therein."

The 1954 Code provides:

> "A corporation shall be treated as engaged in the active conduct of a trade or business if and only if . . . (B) such trade or business has been actively conducted throughout the 5 year period ending on the date of the distribution."

The phraseology "continue the active conduct of a trade or business" is essentially identical to "has been actively conducted." The Fourth Circuit Court of Appeals in the *Bondy* case, supra, and the District Court in *Wilkins*, supra, and now the Second Circuit in *Parshelsky*, hold that a spun-off realty corporation whose sole asset was a building leased

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[3] Respondent's unsupported conclusion that the issues are different (RB Footnote 4) does not bear up under analysis. Indeed, if the 1954 Code were different from the 1951 amendment to the 1939 Code as to the definition of "active trade or business" the Sixth Circuit in **Coody** would not have invalidated the "separate business" requirement.

entirely to the parent corporation was continuing the active conduct of a trade or business.

Clearly the holding of the Third Circuit in this case depends on regulations which have been invalidated in the Sixth Circuit. There is a clear conflict between the circuits on an important area of Federal law.

CONCLUSION.

For the reasons set forth in this reply brief and the original brief it is respectfully submitted that a writ of certiorari should be granted.

Respectfully submitted,

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